



Legislative Audit Division

State of Montana

Report to the Legislature

January 2006

Performance Audit

Local Government Reimbursement For Joint Construction Costs

Montana Department of Transportation (MDT)

This report examines the impact and causes of reimbursement delays from local governments to MDT on joint construction projects. This report identifies the extent of the issue, its impacts, and options available to MDT to address audit issues. We found current reimbursement delays are generally limited to a few local governments. We make recommendations for process improvements to:

- ▶ Reduce MDT's need to seek reimbursement from local governments.
- ▶ Ensure timely reimbursement from local governments.
- ▶ Improve MDT's billing information.

Direct comments/inquiries to:
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Members of the performance audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration, mathematics, statistics, economics, political science, criminal justice, computer science, education, and biology.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

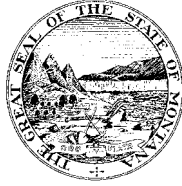
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January 2006

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of local government reimbursement of the Montana Department of Transportation for joint construction costs.

This report contains information on potential audit areas and recommendations for improving current processes. Responses from the Department of Transportation are contained at the end of the report.

We wish to express our appreciation to the staff of Department of Transportation and local government personnel for their cooperation and assistance.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Performance Audit

Local Government Reimbursement For Joint Construction Costs

Montana Department of Transportation (MDT)

Members of the audit staff involved in this audit were Steve Erb and Angie Grove.

Table of Contents

List of Figures and Tables	iii
Appointed and Administrative Officials	iv
Report Summary	S-1
Chapter I – Introduction	1
Introduction.....	1
Audit Objectives	1
Audit Scope and Methodology	1
Issues for Further Study	2
Non-Project Overdue Accounts Receivables.....	2
Are there Advantages to the Establishment of a State Infrastructure Bank?	2
Report Overview/Organization	3
Chapter II - What is the Current Process For Joint Construction Projects?	5
Introduction.....	5
What is the Role of the MDT Districts?	5
What is the Role of MDT Headquarters?	7
Before the Contract is Awarded	8
After the Contract is Awarded.....	9
Paying for the Project	9
Once the Project is Complete	9
What is the Role of Local Governments?	10
Chapter III - The Reimbursement Process.....	11
Introduction.....	11
How Long Are Local Government Accounts Overdue?.....	12
Are All Local Governments Untimely?.....	14
Chapter IV - What Are The Impacts To MDT From Overdue Accounts?	15
MDT's Policy of Pre-funding Construction Costs	15
Highway State Special Revenue Account.....	15
Impact on the Highway State Special Revenue Account Due to Untimely Local Reimbursements	15
Why Are Accounts Overdue?	16
Chapter V - How Do Other States Manage Projects With Local Governments?	17
Introduction.....	17
Other States More Proactive at Managing the Process	17
Making Local Governments Pre-pay Their Portion of Construction Costs.....	19
State Infrastructure Banks.....	19
Charging Interest on Overdue Accounts.....	20
Withholding Transportation Funding Sources.....	20
Gasoline Taxes	21
Montana's Fuels Tax	21
Withholding State Construction Funding	21
Withholding Federal Transportation Funds.....	22

Table of Contents

Chapter VI - How Can MDT Improve Their Current Process?	23
Introduction.....	23
Charging Interest on Overdue Accounts Would Strengthen the Process	23
Another Change Needed is to Withhold Local Transportation Funding Resources.....	24
Statutory Changes May be Necessary	25
MDT Should Reduce its Role in Pre-Funding Construction Costs	25
MDT Should Amend Its Contract Policies and Language for Local Government Projects	26
More Information is Needed for Miscellaneous Items	27
Agency Response.....	A-1
Department of Transportation	A-3

List of Figures and Tables

Figures

Figure 1	MDT Organizational Relationships.....	8
Figure 2	Who is the Most Overdue?.....	11
Figure 3	Average Monthly Due on Local Government Accounts.....	13

Tables

Table 1	Local Governments With More Than Two Projects	12
Table 2	A Comparison of Montana to Other States' Joint Project Funding	18

Appointed and Administrative Officials

Montana Transportation Commission

		<u>Term Expires</u>
William T. Kennedy, Chair	Billings	2009
Nancy Espy, Vice Chair	Broadus	2007
Rick Griffith	Butte	2009
Kevin Howlett	Arlee	2007
Deb Kottel	Great Falls	2009

Administrative Officials

Jim Lynch, Director
Jim Currie, Deputy Director
Monte Brown, Administrator, Administration Division
Loran Frazier, Administrator, Engineering Division
Tim Reardon, Chief Counsel, Legal Services
Sandy Straehl, Administrator, Rail, Transit & Planning
Division
Mark Wissinger, Construction Engineer, Engineering
Division

District Administrators

Bruce Barrett	Billings
Jeff Ebert	Butte
Mick Johnson	Great Falls
Dwane Kailey	Missoula
Ray Mengel	Glendive

Introduction

A performance audit was requested by the Montana Department of Transportation (MDT), and approved by the Legislative Audit Committee, to determine the impact of local governments failing to make timely reimbursement to MDT for construction costs. MDT also requested the audit identify what recourse is available to MDT if timely reimbursement for local costs is not made. Because MDT normally pre-funds all construction costs and then seeks reimbursement for local costs, delayed reimbursement could reduce the funds MDT has available for other projects. Our audit work focused on identifying the prevalence of reimbursement delays, the impact of those delays, what other states do to prevent similar delays, and the internal MDT processes that relate to this issue. This audit and the associated recommendations only address reimbursement delays with local governments.

What is The Current Process?

MDT districts work with local governments to identify highway construction and maintenance needs. Basic costs and schedules are developed and presented to the Transportation Commission for prioritization and contract award. MDT will provide the majority of design, engineering, and management oversight on projects. Local government might, or might not, have local representation on the construction site.

MDT pre-funds joint construction projects from the Highway State Special Revenue Account, which is primarily funded by fees collected from gasoline and special fuels vendors. As costs accrue on construction projects, MDT seeks reimbursement from the Federal Highway Administration and the local government, as appropriate. Information used to bill local governments is gathered by the local MDT project engineer, based on construction estimates taken from the contractor's project award, and forwarded to MDT headquarters in Helena. MDT headquarters then bills local governments for their share of construction costs. Local governments review those bills, request additional information from MDT as necessary, and reimburse MDT for the local portion of costs.

Report Summary

Is The Process Working?

The process is generally working to meet MDT's needs although we did find improvements could be made to reduce reimbursement delays. We conducted a review of MDT accounts receivables reports issued March 2001 through June 2005. Analysis of this information revealed 84 percent of accounts to local governments never become more than 180 days overdue and, on average, are paid off within two months. However, 16 percent of accounts are more than 180 days overdue and it takes MDT nearly 16 months to receive reimbursement. Accounts more than 180 days overdue also have higher average balances than all other overdue accounts combined.

Prior to conducting this analysis, it was thought that smaller governments would have more difficulty meeting MDT reimbursement obligations. Our analysis did not identify any size or type of government that was more prone to being overdue on meeting their reimbursement obligations. A few local governments have been more frequently overdue reimbursing MDT for local construction costs. Those governments account for the majority of MDT's accounts more than 180 days overdue.

What is The Impact to MDT?

Depending on the terms of the contract with the local government, MDT might not see any reimbursement for local costs back into the Highway State Special Revenue Account for an extended time. That portion of the special revenue account not immediately needed by MDT for current costs are invested to generate additional revenues.

We analyzed the potential lost interest revenue from the Highway State Special Revenue Account, from March 2001 through June 2005, from local government accounts that were more than 60 days overdue. We determined that MDT lost more than \$40,000 in interest revenue from the average overdue monthly principal of over \$580,000. This lost interest, and overdue principal, represents potentially lost opportunities to seek additional federal match funds or fund transportation projects for other local governments. This situation results from the lack of repercussions associated with local

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government's untimely reimbursement to MDT for local construction costs.

What Do Other States Do?

We reviewed practices in 11 other states with conditions similar to Montana's to identify other options available to MDT. We found other states are more proactive when dealing with local governments. Other states require local governments to prepay at least a portion of their anticipated construction costs, charge interest on overdue accounts, and withhold local funding to meet reimbursement obligations if necessary. Some state also provided an alternate form of financing to local governments in the form of a state infrastructure bank.

What Can MDT Do to Improve their Current Processes?

Minor policy changes and new statutory tools could help ensure all governments continue to maintain the advantages of participating in joint projects with MDT while encouraging more effective fiscal accountability. As a result of our work, we recommend MDT:

- ▶ Since local governments already budget for these projects, require local governments pre-fund at least a portion of their anticipated construction costs prior to contract award.
- ▶ Amend contract language with local governments to require monthly billing and reimbursement of local construction costs.
- ▶ Seek specific statutory authorization to charge local governments interest and withhold future local disbursements of state collected transportation related funds on overdue accounts.

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Chapter I – Introduction

Introduction

The Montana Department of Transportation (MDT) frequently enters into contracts with local governments, which include work for local governments at the same time MDT is conducting work on a state highway. Local governments (town, city, municipality, county, etc.) agree this process can provide significant benefits. Under normal circumstances, MDT pre-funds construction costs and then seeks reimbursement from the local government for their portion of project costs. There are times when delays occur in reimbursing MDT for those local costs. A performance audit of this process was requested by MDT and approved by the Legislative Audit Committee.

Audit Objectives

We developed the following audit objectives:

1. Determine the impact of local governments failing to make timely reimbursement to MDT for construction costs.
2. Compare how other states manage their joint projects with local governments.
3. Determine what recourse is available to MDT if local governments do not reimburse MDT in a timely manner.

Audit Scope and Methodology

Our review examined internal processes used by MDT to develop contracts with local governments and how billing related information is passed from the local MDT project manager through levels of MDT and, ultimately, passed on to the local government for payment. We also reviewed what local governments believe to be the primary causes of their delays in reimbursing MDT for construction costs. The audit period was March 2001 through June 2005. Our audit did not examine what causes disputes on the construction project resulting from change orders or the interaction between MDT and the local government over those changes. Information provided in this report relates only to MDT-local government construction contracts unless specifically indicated.

The audit objectives were addressed by examining Montana statutes, MDT/local government contracts, analyzing MDT processes and reports, and conducting interviews with MDT, local government, and federal officials. To determine other options available to MDT, we

Chapter I – Introduction

contacted officials in eleven similar states to identify procedures in place between those states and their corresponding local government contracts.

Issues for Further Study

During this audit, we identified other issues that could be considered for further study.

Non-Project Overdue Accounts Receivables

The focus of this audit was on joint construction projects and reimbursement issues with local governments involving those projects. However, during our review of MDT's accounts receivables reports, we identified numerous overdue accounts receivables accounts that were not project related. During fiscal year 2003, overdue amounts on accounts owed by private individuals, non-government entities (such as utilities and communications companies), and local governments ranged from \$42,700 to \$334,500 with an average monthly balance of \$198,000. There is no indication of penalties imposed against these overdue accounts or whether these accounts result in no-interest loans. Potential audit scope would focus on the overall extent of these overdue accounts, and whether the state is losing use of available funds or revenue on these accounts.

Are there Advantages to the Establishment of a State Infrastructure Bank?

There are a number of costs to local governments associated with raising funds for joint construction costs. The cost of issuing bonds can be substantial and can approach \$25,000 per bond. Repayment interest rates can vary depending on the financial strength of the government entity issuing the bond. One option for providing an additional source of funding for local governments is the establishment of a state infrastructure bank.

The federal government has identified the establishment of a state infrastructure bank as an option for funding local transportation-related costs. According to information from the Federal Highway Administration (FHWA), by the end of fiscal year 2003, state infrastructure banks previously established in 31 states had made 356 loans with a value of \$4.5 billion. FHWA claims infrastructure banks boost community development, provide cash flow financing,

assist high priority projects, and improve financial access for diverse communities.

However, the success of infrastructure banks has varied from state to state. State infrastructure banks in Arizona, Florida, Ohio, and Texas have made an average of 40 loans valued at nearly \$350 million since they were established. According to the 2004 Pennsylvania Infrastructure Bank Annual Report, one of the states contacted during this audit, Pennsylvania has provided \$30 million in loans to 44 borrowers on projects worth an estimated \$128 million. Alaska, Arkansas, Delaware, Rhode Island, Tennessee, Utah, and Virginia's infrastructure banks have only provided one loan each with an average loan amount of \$4.7 million.

Montana has not established an infrastructure bank under previous federal transportation bills. We discussed the potential of establishing a state infrastructure bank in Montana based on authorization included in the 2004 federal transportation-funding bill for use by local governments to pre-fund the local portion of joint construction costs. MDT officials stated they have considered infrastructure banks in the past but have avoided them because of their impact on existing construction plans. MDT is concerned because the funds to capitalize a state infrastructure would have to come out of Montana's existing federal transportation allocation and these funds have already been identified in future state projects. Capitalizing a state infrastructure bank would require MDT to re-direct funding for previously planned projects.

Report Overview/Organization

This report will respond to our audit objectives in the following manner:

- ▶ Chapter II provides an overview of the roles of the stakeholders in a joint construction project and how the process currently works.
- ▶ Chapter III discusses the effectiveness of the reimbursement process.
- ▶ Chapter IV discusses the impacts of untimely local reimbursement to MDT for construction costs.

Chapter I – Introduction

- ▶ Chapter V addresses how other states manage their joint state-local projects and some of the options available to MDT to manage this process.
- ▶ Chapter VI recommends options available to MDT if local governments do not reimburse MDT in a timely manner for their construction costs.

Chapter II - What is the Current Process For Joint Construction Projects?

Introduction

When the Montana Department of Transportation (MDT) enters into a joint construction project with local government, the normal process is for MDT to plan, manage, and pre-fund the project. MDT's normal policy is to fully fund the project, including the local portion of construction costs, and then seek reimbursement from both the local government and the Federal Highway Administration (FHWA) for their share of project costs. MDT's contract requirements generally identify maximum levels of state/federal funding support and estimate the local government's costs above this maximum. The local government is then responsible for all costs that exceed maximum state/federal funding levels, even if over original estimates.

Joint construction projects, generally reduce local costs associated with maintaining or replacing infrastructure elements such as sewer or water lines normally located underneath state maintained roads. Under Montana statutes, MDT is responsible for maintenance and construction costs of state and federal highways. In many regions of the state, these same roads make up the main street of the local community. If MDT conducts work on these roads, it is responsible for the associated costs. If the local government conducted maintenance on their water system located underneath the state highway passing through the middle of the town without including MDT in the project, it would be required to tear up the road to get at the water lines and then restore the road to MDT standards after work was completed, all at local cost. If the local government conducted their maintenance at the same time MDT was scheduled to replace the road surface, then the local costs would be reduced to those costs related to their water system. The local government eliminates the cost of tearing up and replacing the road.

What is the Role of the MDT Districts?

Many of the projects MDT enters into with local governments are initiated in one of MDT's five districts (Butte, Missoula, Billings, Glendive, and Great Falls). The district offices work with local governments to identify potential projects as funds become available.

Chapter II - What is the Current Process For Joint Construction Projects?

Once a project has been identified, it must be submitted to the Transportation Commission. The Transportation Commission is a board, composed of five individuals appointed by the governor representing each of the MDT districts, responsible for approving and prioritizing the state's transportation construction projects. The commission also awards all contracts on state transportation construction projects. After the Transportation Commission approves the project; funding is secured; and the contract is awarded. After those steps are completed, the district office provides daily project management.

Daily project management includes assigning a district project engineer who is responsible for supervising the contractor, verifying material quantities used on the project (concrete, fill, piping, gravel, etc.), conducting required quality testing, maintaining records (the daily log, daily diary, and computerized progress estimate spreadsheet), interacting with local government representatives, and ensuring that documentation necessary for paying the contractor and billing both the FHWA and local government is forwarded to MDT headquarters in Helena. The MDT project engineer is also responsible for ensuring the project is completed according to nationally established standards. Assisting the district project engineer is the district office engineer. The office engineer consolidates information from various project managers in the district and submits the information to the construction office in Helena via a progress estimate spreadsheet.

The progress estimate spreadsheet provides a listing of all estimated line items identified in the contract with the contractor. The progress estimate allows the project engineer to track how many items are actually used on the project versus how many were estimated at the beginning of the project. Actual quantities reported on the spreadsheet become the basis for billing FHWA and the local government. The spreadsheet is combined with the daily diary and the daily log to give detailed information on individual events that occurred on the project. The daily diary is a compilation of major activities planned for the day, a listing of who was on the project

Chapter II - What is the Current Process For Joint Construction Projects?

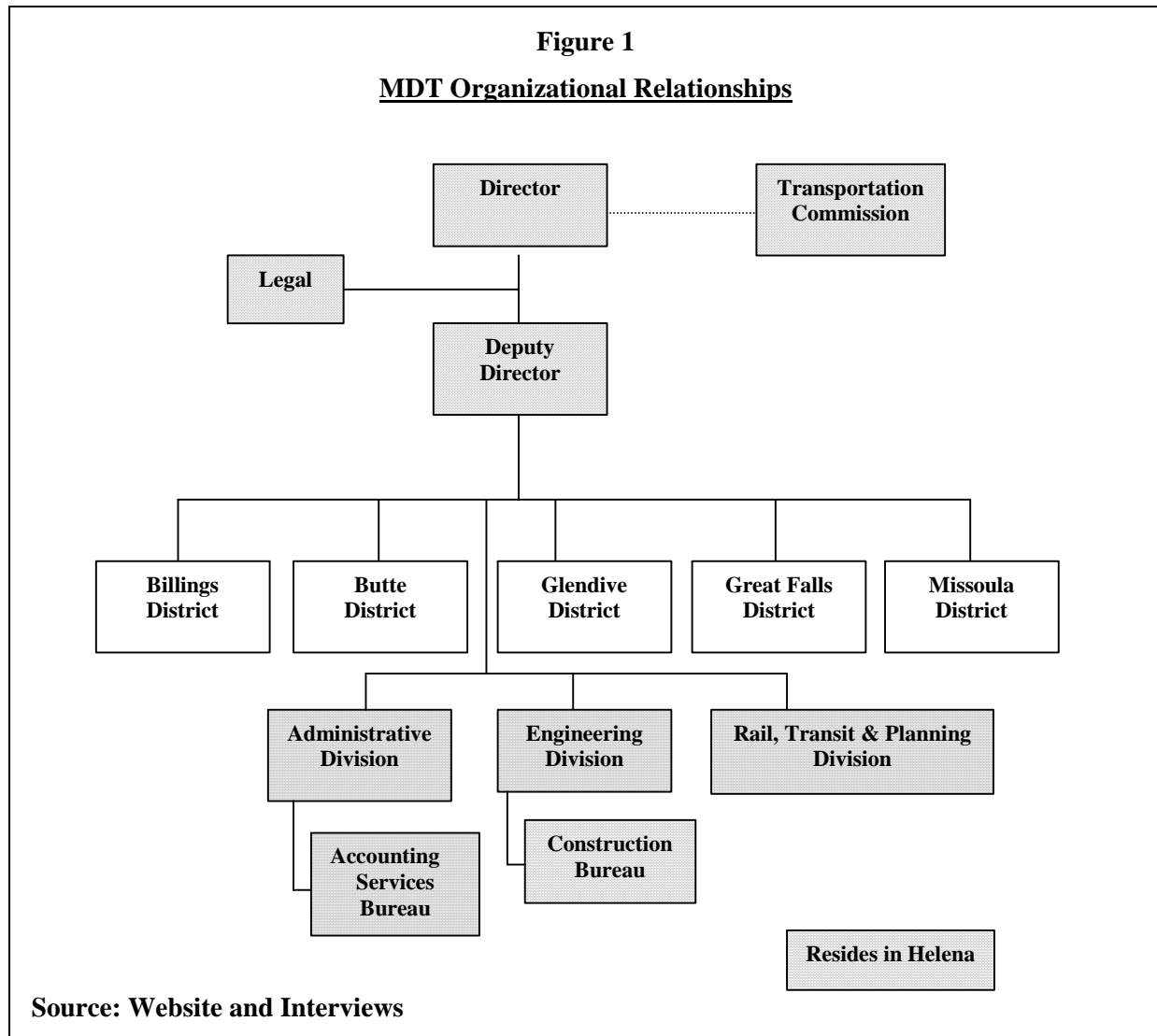
during the day, and the atmospheric conditions that existed during the day. The daily log provides a listing of all inspections conducted, their results, and detailed notes on project milestones. In the event there is a question on a bill from a local government, the daily log will generally provide the details necessary to address any questions.

Once the construction project is completed, all inspections have been completed satisfactorily, and miscellaneous requirements have been met, the final progress estimate spread sheet is prepared and forwarded to MDT headquarters. This final project closeout can be delayed for over a year depending on the terms of the contract with the contractor. For example, required landscaping and chip sealing might have to be delayed until the following spring on projects that were completed in the late fall.

What is the Role of MDT Headquarters?

MDT headquarters, located in Helena, has a number of major roles that effect interaction with local governments. These range from providing information to the district offices and local governments about special federal construction and funding programs, allocating funds used to fund transportation projects throughout the state, and ensuring state-funded construction projects meet minimum design standards. The relationships between MDT divisions are identified in the figure below.

Chapter II - What is the Current Process For Joint Construction Projects?



Before the Contract is Awarded

MDT will develop project estimates used to identify potential costs. These estimates will form the basis of federal funding limits. Once project costs are estimated, MDT Headquarters assists local governments in identifying funding sources for the project. MDT Headquarters then presents the project to the Transportation Commission for approval and prioritization. If the project is approved, MDT Headquarters will develop the project design that will be bid on by contractors interested in the project.

Chapter II - What is the Current Process For Joint Construction Projects?

After the Contract is Awarded

After the contract is awarded, MDT Headquarters generates progress estimate spreadsheets based on work efforts included in the contractor's bid package. The local project engineer monitors contractor performance based on these progress estimate spreadsheets. These progress spreadsheets will break down the project into the "splits" that have been established to identify which funding source will pay what percentage of the specific work being conducted. Splits could be 100 percent federal, state, or locally funded, 75/25 state/local, or any other combination. The Accounting Services Bureau of the Administrative Division tracks expenditures and invoices the appropriate governments for reimbursement of MDT expenses based on the terms of the contracts and the established splits.

Paying for the Project

MDT relies on the Highway State Special Revenue Account to pay construction costs until it receives reimbursement from other parties to the construction project. The Highway State Special Revenue Account is established by Montana statutes to fund the state's transportation infrastructure. The Highway State Special Revenue Account is funded in part by the Gasoline, Aviation, and Special Fuel License Tax collected from the sale of each gallon of fuel and paid by the fuel vendors. These funds are collected by gasoline and special fuel distributors throughout the month and submitted to MDT the following month.

Once the Project is Complete

After the final completed project estimate is received in Helena, the Construction Bureau compares all project quantities to project estimates and the project logs to ensure nothing appears out of the ordinary and all aspects of the project are closed. The Construction Bureau then sends a final notice to the Accounting Services Bureau that after 30 days, there should not be any future costs or invoices associated with the project. Once the 30 days has elapsed, all project logs, diaries, and project documents are packaged for storage in the bureau's project archives.

For the Accounting Services Bureau, the project is closed out once the contractor has been paid for all work completed and all MDT

Chapter II - What is the Current Process For Joint Construction Projects?

costs have been reimbursed, either by FHWA or the local government.

What is the Role of Local Governments?

The local government's Public Works Department, or its equivalent, normally maintains close ties with its associated MDT district office. At times, it will be the local government that will initiate a work effort with MDT based on an emerging local need. The local government's project approval process is similar to that employed by MDT with approval and funding authority normally resting with the local City or County Commission.

Once a project is approved, local government representatives work with MDT to ensure local requirements are met. In some cases, local governments will complete pre-project work using their own contractors, such as relocating utilities impacted by the overall project. In these cases, depending on how the project costs are identified, the local government will either pay for this work directly or submit invoices to MDT for payment. In other cases, this pre-project work will be included in the project plans and be completed by the project contractor. The local government will then be billed for this work as part of the contract.

After MDT submits its bill to the local government for reimbursement, local governments review the bill for accuracy. If questions occur, local governments will request additional information from MDT before paying.

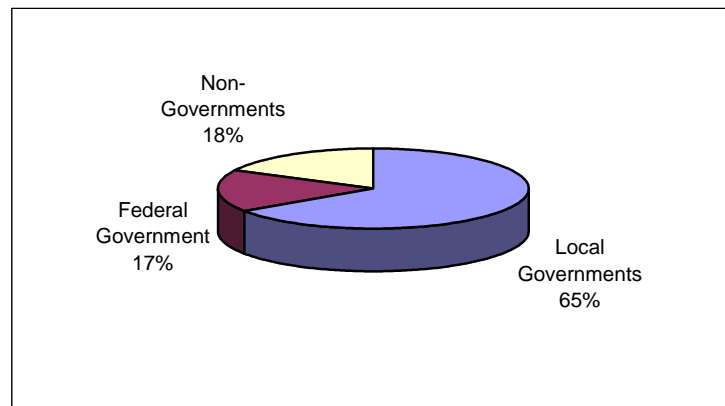
Chapter III - The Reimbursement Process

Introduction

Since March 2001, the Montana Department of Transportation (MDT) has participated in projects with 39 different government entities (to include the federal government) and 20 different non-government entities. Non-government entities could be construction-related companies, utilities, nonprofit foundations, or even individuals. We conducted analysis to determine if local government, federal government, or private organizations are responsible for more overdue accounts. Each account was reviewed to determine how many months the account had been in an overdue status. In the event there was more than one account to the organization, all months were added together to get a single tally of overdue months. The results of that analysis are shown in Figure 2.

Figure 2

Who is the Most Overdue?



Source: Legislative Audit Division analysis of MDT accounts receivable reports (March 2001 through June 2005).

We found local governments were responsible for roughly two-thirds of the total months that accounts were more than 180 days overdue. Accounts involving the federal government and non-governments split the remaining overdue time. In some cases, there were multiple accounts for different projects with the same government or organization. For example, Butte had four different projects/accounts, Great Falls seven, Missoula four, and Helena seven. In other cases, the same project might involve multiple

Chapter III - The Reimbursement Process

governments/organizations. For example, McCone County and QWEST were both billed for different portions of the same project. Table 1 identifies those governments that had two or more projects with MDT during our review period.

Table 1
Local Governments With More Than Two Projects

<u>Government</u>	<u>Number of Projects</u>
Great Falls	7
Helena	7
Butte	4
Missoula	4
Billings	4
Kalispell	3
Bozeman	3
Polson	3
Park County	2

Source: Compiled by Legislative Audit Division.

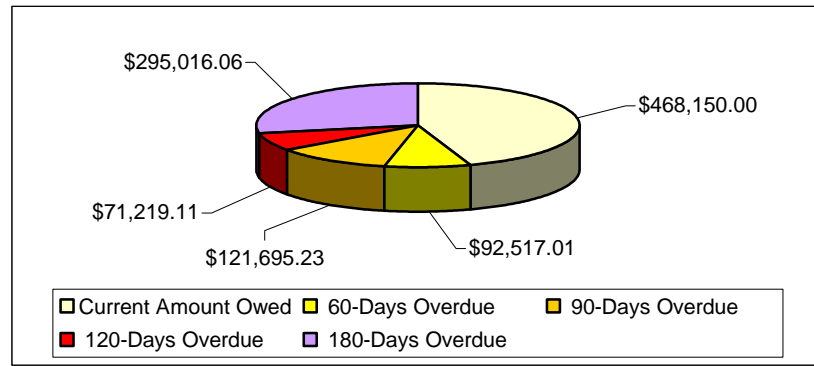
How Long Are Local Government Accounts Overdue?

We conducted an analysis of all MDT project accounts receivables reports from March 2001 through June 2005 to examine how timely MDT recovers costs. Based on this review, we found there was an average of \$1,048,597 in total monthly billings to local governments on joint construction projects. Total monthly billings include a monthly average of \$468,150 in current billings and \$580,447 in overdue billings. To track timeliness of payments and the amount owed on the different projects, MDT categorizes its accounts as current, over 60 days, over 90 days, over 120 days, and over 180 days. The largest portion of overdue balances, those accounts more than 180 days overdue, averaged more than \$295,016 monthly. Detailed balances for each overdue category are provided in the Figure 3 below.

Chapter IV - What Are The Impacts To MDT From Overdue Accounts?

Figure 3

Average Monthly Due on Local Government Accounts



Source: Legislative Audit Division analysis of MDT accounts receivables reports (March 2001 through June 2005).

During our initial review of account information we noticed a change in pay off times between accounts more than 180 days overdue and accounts less than 180 days overdue. Further analysis confirmed the majority of MDT accounts, 84 percent, are paid off before they are more than 180 days overdue. For these accounts, the average pay off period was 1.92 months. The remaining 16 percent of accounts are over 180 days overdue. Once an account is more than 180 days overdue, the average pay off period is 15.6 months. Once accounts are more than 180 days, they take significantly longer to payoff. Combined with the fact that accounts more than 180 days overdue are over half of the total average overdue balance, MDT loses the ability to use these overdue funds for other construction opportunities for extended periods of time.

Conclusion: The majority of accounts are paid off before they are more than 180 days overdue. However, once an account is 180 days overdue, it takes significantly longer to pay off the account and those accounts have higher balances.

Chapter III - The Reimbursement Process

Are All Local Governments Untimely?

Local governments were responsible for the majority of the accounts overdue more than 180 days. However, not all local governments had overdue accounts. Prior to reviewing account data, we assumed smaller local governments would have had a more difficult time reimbursing MDT for local construction costs. Our analysis did not identify any common characteristics to identify those governments that would tend to be overdue reimbursing MDT for local construction costs. During our 4-year review period, MDT entered into agreements with 31 different city, town, and county governments. Eleven of these governments were not identified in MDT reports as being overdue on their payments. These included Wibaux, Livingston, Thompson Falls, Wolf Point, Billings, Bozeman, Red Lodge, and Jefferson, Deer Lodge, McCone, and Yellowstone Counties. Nine of the remaining governments had overdue accounts that never became overdue by more than 180 days. The remaining eleven governments; Helena, Great Falls, Missoula, Sidney, Townsend, Butte, Hamilton, Laurel, Ft. Belknap Indian Reservation, Whitehall, and Eureka had accounts overdue more than 180 days.

Closer examination of these eleven accounts, revealed two governments were in an overdue status longer than all the other local governments combined. Helena and Great Falls were responsible for a combined 217 months where their accounts were overdue by more than 180 days. This equates to 40 percent of the total time accounts were more than 180 days overdue. For comparison purposes, reimbursement delays from a federal research project and a non-governmental entity have been responsible for 17 and 18 percent respectively of the accounts more than 180 days overdue.

Conclusion: MDT's reimbursement process generally functions to meet MDT's needs. However, a few local governments have been more frequently overdue reimbursing MDT for local construction costs. Those few account for the majority of MDT's accounts more than 180 days overdue.

Chapter IV – What Are The Impacts To MDT From Overdue Accounts?

MDT's Policy of Pre-funding Construction Costs

The Montana Department of Transportation's (MDT) current policy is to pre-fund all local construction costs. This means MDT pays all construction costs and then seeks reimbursement for the local government's portion of construction costs. The implication of this policy is that, depending on contract terms and duration of the construction project, the state might not see any reimbursement for local costs for an extended time. Between March 2001 and June 2005, local governments were billed approximately \$10.3 million on construction projects. This amount was pre-funded from the Highway State Special Revenue Account.

Highway State Special Revenue Account

MDT relies on the Highway State Special Revenue Account to pre-fund all transportation-related joint construction projects. This account is also the state's source of funds to meet match requirements for federal transportation construction dollars. According to audited 2005 fiscal year end data, the Highway State Special Revenue Account received over \$252 million during the year from various taxes, interest income, and other fees. Funds not required to meet MDT's anticipated short-term needs are invested through the Board of Investments to develop additional revenue for the account. MDT managers regularly monitor the account's balance to ensure sufficient funds remain available to meet federal match requirements, thereby maximizing the state's availability of federal funding.

Impact on the Highway State Special Revenue Account Due to Untimely Local Reimbursements

We analyzed the potential lost interest revenue from the Highway State Special Revenue Account, from March 2001 through June 2005, based on local government accounts overdue more than 60 days. We charted the amount overdue for each local government against the investment rate of return for the same period to determine the interest lost to the Highway State Special Revenue Account. We found MDT lost over \$40,000 in interest revenue for the Highway State Special Revenue Account during the 4-year review period. This is interest lost on the average overdue monthly principal of over \$580,000. This overdue balance, and its lost interest revenue,

Chapter IV - What Are The Impacts To MDT From Overdue Accounts?

represents funds that are unavailable to MDT to fund other transportation projects for other local governments.

Conclusion: MDT has lost interest revenue and the opportunity to use overdue funds to start other construction projects.

Why Are Accounts Overdue?

There are a number of reasons given by local governments as to why accounts are overdue. One is the lack of detail included in bills from MDT, particularly when associated with “miscellaneous” line items. Requests for additional detail after receiving a bill will extend the reimbursement period. Our review confirmed this as a cause of delayed payments. Another reason given for delayed reimbursement is the amount of information that needs to be verified when the local government receives the bill. This is especially true if billing occurs on a cycle other than monthly. However, while both situations might result in temporary delays (60-90 days) in reimbursement, they cannot account for the differences in pay off periods for accounts more, or less, than 180 days overdue. These reasons also do not explain why other local governments are able to deal with these same issues and manage to reimburse MDT within 60 days of billing.

We identified other potential reasons for untimely payments from local governments. The primary one being a lack of penalties or negative repercussions for not paying accounts on time. MDT charges no interest on overdue accounts nor withholds local distribution of transportation-related funds if reimbursement is overdue. The result is local governments failing to reimburse MDT for local construction costs before entering an overdue status are effectively getting an interest free loan from the State of Montana. In addition, funding support from MDT continues regardless of overdue account status. Projects are not delayed or eliminated.

Conclusion: There are no repercussions associated with a local government’s untimely reimbursement to MDT for local construction costs.

Chapter V - How Do Other States Manage Projects With Local Governments?

Introduction

As part of our analysis, we contacted eleven other regional and demographically (climate, population, and/or size) similar states. The states contacted included South Dakota, North Dakota, Wyoming, Idaho, Washington, Oregon, Utah, Nevada, Minnesota, New Hampshire, and Pennsylvania. We found very few of these other states conducted business with their local governments in the same manner as Montana.

Other states require local governments to prepay at least a portion of their anticipated construction costs, charge interest on overdue accounts, and withhold local funding to meet reimbursement obligations were all options. Some states also provided an alternate form of financing to local governments in the form of a state infrastructure bank. Most of the states commented that while their departments of transportation have options to use with local governments if needed, many chose not to use the options provided unless other mediation steps have failed.

Other States More Proactive at Managing the Process

There are a number of options used by other states that permit them to take a more proactive stance than Montana when dealing with local governments, particularly as it relates to the paying for local construction costs. The following table summarizes how Montana compares to these other states. Items highlighted in yellow indicate practices different from Montana.

Chapter V - How Do Other States Manage Projects With Local Governments?

Table 2

A Comparison of Montana to Other States' Joint Project Funding

	State Provides Upfront Project Funding	Requires Pre-payment of Initial Costs	Charges Interest on Overdue Accounts	Withholds Gas Tax Proceeds	Withholds State Aid Funding	Withholds Federal Funds	State Infrastructure Bank
Montana	Yes	No	No	No	No	No	No
South Dakota	Yes	No	Yes, equal to state's investment rate on long term repayment contracts	No	No	No	Yes
Pennsylvania	No	Yes	1% of overdue payment after 15 days	Yes	Dependent on Situation	Dependent on Situation	Yes
North Dakota	Yes	No	No	Yes	No	No	Yes
Minnesota	No	Yes	1.5%/Month. After 30 days	Yes	Only to cities with populations greater than 5,000	Yes	Yes
New Hampshire	Maybe	50% paid prior to start of project Construction.	No	No	Yes	No	No
Wyoming	Yes	No	No	No	Can delay future projects	No	Yes
Washington	Yes	Can be required but is not the normal procedure	1.0%/Month	Yes	Yes	No	Yes
Oregon	Yes for some programs	110% of estimated local costs to be placed in Local Government Investment Pool prior to construction planning	No	Yes	Yes	No	Yes
Idaho	No	Yes	No	No	No	Yes, future projects can be delayed	No
Utah	No	Yes	No	No	Yes	Yes	Yes
Nevada	Yes	Funding stream must be in place	No	No	No	No	No

Source: Compiled by the Legislative Audit Division.

Chapter V - How Do Other States Manage Projects With Local Governments?

Making Local Governments Pre-pay Their Portion of Construction Costs

Eight of the eleven states contacted had the option of either requiring local governments pre-fund a portion of their anticipated construction costs, or required proof a local funding stream for the project was in place before the project was planned. New Hampshire required a 50 percent deposit depending on how the project was managed and the type of project. Depending on the project, Oregon requires a deposit of 110 percent of anticipated local construction costs into a local government investment pool before the construction planning begins. Pennsylvania, Minnesota, Idaho, and Utah also require local governments to pre-pay the local portion of anticipated construction costs. Washington can require local governments pre-fund a portion of local costs.

Wyoming, South and North Dakota, Washington, and Nevada provide all construction funding for local governments and then require reimbursement for local costs later in the project. While Nevada pre-funds construction projects, it also requires local governments document a funding stream to reimburse the state for local costs before project planning begins.

State Infrastructure Banks

One option available to help local governments fund their portion of joint construction costs is to place a portion of the state's federal transportation funding allocation into a state infrastructure bank (SIB). When federal legislation in 1995 authorized the first SIBs, the program was viewed as a means of speeding up local projects and reducing local costs. The program began with ten original test states. Since then, successive federal transportation authorizations have expanded the SIB program to 31 states and the most recently authorized 2005 federal transportation funding bill, known as the Safe, Accountable, Flexible, and Efficient Transportation Equity Act of 2005: A Legacy for Users (SAFETEA-LU) authorized states that have not yet done so to implement SIBs.

Under the terms of the federal legislation, SIBs can be used to loan funds to local organizations for transportation-related projects. These loans are to have repayment periods of not greater than 30 years and rates of interest are to be at or below market interest

Chapter V - How Do Other States Manage Projects With Local Governments?

rates. Under the SAFETEA-LU authorization, states are allowed to put up to ten percent of their federal funds into an infrastructure bank. States must provide a 25 percent match on these funds. Revenues generated by interest on loans and the return of principal continually recapitalize the bank.

Wyoming, Washington, South Dakota, North Dakota, Utah, Pennsylvania, Minnesota, and Oregon, have established state infrastructure banks (SIB) as authorized by federal transportation funding legislation. Each state has had different results with their SIB. Pennsylvania has chosen to provide additional funding for its SIB, beyond those required by federal standards, because of the successes that have occurred providing local governments assistance for infrastructure projects. Montana has chosen not to establish a SIB in the past because all federal and matching state funds have already been identified to fund projects. Using those funds to capitalize a SIB would mean rescheduling future/proposed projects.

Charging Interest on Overdue Accounts

Four of the eleven states (South Dakota, Pennsylvania, Minnesota, and Washington) charge interest on overdue accounts. Minnesota's authority to charge interest is established in state statutes with the rate set at 1.5 percent per month (18 percent annually) on balances overdue more than 30 days. Pennsylvania's authority is established under the terms of the loans provided through its state infrastructure bank process. Washington includes language in its contracts with local governments stating interest will be charged on overdue accounts. South Dakota charges local governments the same amount of interest that would be lost from the state's construction account when long-term repayment terms are included in the contract with the local government. In both Washington and Pennsylvania, the local government can be charged up to 1 percent per month on overdue balances with Pennsylvania charging interest after 15 days.

Withholding Transportation Funding Sources

Eight of the eleven states are authorized to withhold the local government's share of transportation related revenues if the local government has failed to reimburse the state for construction costs.

Chapter V - How Do Other States Manage Projects With Local Governments?

These revenue sources include local gasoline taxes, state construction funds, and federal transportation funds.

Gasoline Taxes

All states in our survey generated funds to support the state's transportation construction programs by imposing a tax on gasoline sales. A portion of these taxes are returned to local governments to meet their own transportation construction needs. Five of the eleven states (Pennsylvania, North Dakota, Minnesota, Washington, and Oregon) are contractually permitted to withhold a local government's share of the state's gasoline taxes to meet overdue repayment obligations.

The time between when the account is overdue and when gasoline tax proceeds can be withheld varies from state to state. In Pennsylvania, gasoline taxes are normally pledged as part of the repayment terms included in infrastructure bank loans. Contracts established with local governments state Washington and Oregon can withhold gasoline taxes after 90 days; in North Dakota those same terms indicate gas taxes can be withheld after 60 days.

Montana's Fuels Tax

Montana statutes (Title 15, Chapter 70) establish the Gasoline Distributor's Licensing Tax and the Special Fuels Tax, for the purpose of meeting the state's transportation needs. A portion of the collected taxes are statutorily redistributed to local governments through a formula based on a number of factors, including population, miles of road, rural or urban environment. Motor vehicle fuel taxes can only be used to fund transportation-related expenses, such as road construction and maintenance. Montana statutes do not give the Montana Department of Transportation (MDT) specific authorization to withhold local government's share of motor vehicle fuels taxes as reimbursement for costs related to the local share of construction projects.

Withholding State Construction Funding

Six of the eleven states surveyed specifically authorize their departments of transportation to withhold state transportation aid funding if the local government is overdue reimbursing the state for local construction costs. Minnesota and New Hampshire only use

Chapter V - How Do Other States Manage Projects With Local Governments?

this option against larger governments. A seventh state, Wyoming, commented that while not specifically included in contract language, it is understood by local governments that failure to meet reimbursement obligations could result in future construction projects being delayed until the previous funds have been repaid.

Withholding Federal Transportation Funds

Four of the eleven states indicated that a local government's failure to make timely reimbursement to the state for local construction costs can result in the state withholding federal funds that could be distributed locally. Federal Highway Administration (FHWA) officials contacted during this audit confirmed that the funds distributed to the state from the FHWA for transportation construction projects are to be distributed as the state sees fit. The only exception is that those funds that are "earmarked" in the transportation-funding bill cannot be withheld from the local government. A state can choose to distribute, or deny, funds to a particular government based on any criteria that meets the state's construction needs.

Chapter VI - How Can MDT Improve Their Current Process?

Introduction

Montana Department of Transportation's (MDT) participation in joint construction projects with local governments has provided opportunities for local governments to improve their infrastructure with reduced costs. Some local governments have taken advantage of MDT policies. A number of states have taken action requiring local governments pre-fund local construction costs, which reduces or eliminates the need for states to seek reimbursement in the future. Other states have chosen to implement various penalties if local governments fail to meet their reimbursement obligations. These range from charging interest on overdue accounts to withholding the local share of transportation funding resources. None of these actions are currently pursued in Montana.

Minor policy changes and new statutory tools could ensure all governments continue to enjoy the advantages of participating in joint projects with MDT while encouraging more effective fiscal accountability. MDT can improve its existing process by:

- ▶ Seeking specific statutory authorization to charge local governments interest and withhold local disbursements of state collected transportation related funds on overdue accounts.
- ▶ Requiring local governments pre-fund at least a portion of their anticipated construction costs prior to contract award.
- ▶ Billing local governments monthly for all local costs.
- ▶ Amending contract language with local governments to require payment of local construction costs on a monthly basis and to reflect proposed statutory changes.

Each of these actions is discussed in greater detail in this chapter.

Charging Interest on Overdue Accounts Would Strengthen the Process

A change to Montana statutes authorizing the department to charge local governments an interest rate at least equal to the state's investment interest rate on any overdue account would strengthen the current process. MDT currently has no authorization in statute allowing the department to charge local governments interest on overdue accounts. This has resulted not only in lost revenue for the

Chapter VI - How Can MDT Improve Their Current Process?

Highway State Special Revenue Account, but has encouraged local governments to delay payment to MDT.

From March 2001 to June 2005, MDT lost over \$40,000 in interest revenue due to late reimbursements from local governments. If Montana were to charge interest of 1 percent per month, the potential charge to local governments that failed to meet reimbursement obligations would have been \$244,930. This would have resulted in a penalty of nearly \$205,000 on the overdue balance of \$580,000. Charging interest on overdue accounts would solve two issues. First, MDT would recover lost investment interest revenues. Second, local governments would have a penalty associated with failing to meet their reimbursement obligations, creating a more equitable process for all local governments. The precedent for charging governments interest on overdue accounts has already been established in Montana statutes. MDT can be charged 10 percent interest on any overdue payments to contractors. In addition, local governments can be charged 0.05 percent daily interest on overdue accounts to non-government suppliers and services providers, including construction services.

Another Change Needed is to Withhold Local Transportation Funding Resources

MDT currently has no specific statutory authorization to withhold a local government's share of motor vehicle fuel tax revenues that would normally be disbursed to those governments for their transportation construction costs. This lack of authorization leaves MDT with no means of recovering costs it has already paid for a local government during the course of a construction project if reimbursement is not made in a timely manner. The precedent for such an action already exists in other programs, both within MDT, with the gasoline vendor's offset authority, and other areas of state government, with the income tax refund offset program.

Based on the results of our survey of other states, it is common that withholding local vehicle fuel tax disbursements does not occur unless accounts are 60 to 90 days overdue. In Montana, this would prevent a majority of local governments from having their tax disbursements withheld considering that the average repayment period for most accounts was 1.92 months. This delay would also

Chapter VI - How Can MDT Improve Their Current Process?

give local governments an appropriate time period to review bills and request any additional detailed information needed to confirm the appropriateness of the bill. Having both options available, charging interest on overdue accounts and withholding fuel tax revenues, is needed to ensure MDT has the flexibility to respond to future situations.

Statutory Changes May be Necessary

The net effect of current MDT practices is to provide interest free loans to local governments that fail to reimburse local construction costs in a timely manner. To encourage more effective accountability, it may be necessary for MDT to seek changes to Montana statutes giving the department authority to hold local governments accountable for failing to meet financial obligations.

Recommendation #1

We recommend MDT:

- A. Charge local governments interest on overdue accounts.**
- B. Withhold local disbursement of state collected transportation related funds when local governments fail to reimburse MDT for construction costs within an established timeframe.**
- C. If necessary seek statutory authority to implement actions A and B.**

MDT Should Reduce its Role in Pre-Funding Construction Costs

Local government leaders have indicated they would be willing to pre-fund at least a portion of their anticipated construction costs. During discussions with local government leaders, a question raised was whether local governments could afford to pre-pay at least some of the anticipated local construction costs on MDT projects. All local leaders we interviewed commented that when they enter into an agreement with MDT, they have already budgeted for the anticipated costs. The only real concern raised by local governments was potential funding might be tied to federal grants and timing of the award does not coincide with pre-payment timelines identified in the construction contract. Local leaders have indicated they could pre-fund at least 50 percent of their anticipated project costs.

Chapter VI - How Can MDT Improve Their Current Process?

As identified in our survey results, a majority of other states either require the local government to pre-fund at least a portion of their anticipated project costs or require proof a funding source is already in place. At least fifty percent of anticipated local pre-funded costs could be placed in an interest bearing escrow account prior to contract award. All interest generated on local funds could be used to supplement local funds. Any unused portion of the account would be returned to the local government after the final bill has been paid.

Requiring local governments to pre-fund part, or all, of their anticipated construction costs, would have four positive affects. First, the Highway State Special Revenue Account would have fewer funds tied up on projects awaiting reimbursement by the local government. Second, the Highway State Special Revenue Account would benefit from additional investment interest revenue due to higher balances available for investment, albeit this revenue would likely be relatively insignificant. Third, by requiring project pre-funding by local governments, MDT would be seeking less reimbursement from those local governments during and after the project is completed. Fourth, making local governments pre-pay their own construction costs would eliminate the ability of some governments to use MDT funding as a no-interest loan by delaying reimbursement to MDT for an extended period.

Recommendation #2

We recommend MDT require local governments pre-fund a portion of their anticipated local construction costs prior to contract award.

MDT Should Amend Its Contract Policies and Language for Local Government Projects

How MDT structures contracts with local governments impacts when those local governments will begin reimbursing the account for costs already paid by MDT. Currently, MDT contracts do not routinely require monthly reimbursement for the local portion of construction costs. In fact, there does not appear to be any standard language regarding reimbursement terms with local governments. We identified three different examples of reimbursement language, none of which clearly required monthly reimbursement of construction costs.

Chapter VI - How Can MDT Improve Their Current Process?

One version of current language requires reimbursement within 30 days of billing on costs exceeding the maximum federal funds available for the project. The implication is that no costs are paid until after the federal funds had been exhausted. We also identified contracts that required the local government to pay all local costs at the completion of the project. We did find examples of contracts that would require the invoicing of local governments monthly, but there was no language requiring monthly reimbursement. In other words, there are no standard repayment terms in contracts between MDT and local governments.

MDT managers have recognized the need for standardizing contract reimbursement language. MDT managers indicated a policy had been drafted requiring all MDT divisions involved in developing contracts with local governments to require local government provide reimbursement to MDT for local construction costs on a monthly basis. However, we found no evidence this policy has been disseminated throughout the organization. MDT should formally issue a policy requiring all future contracts with local governments include contract language that requires local governments to reimburse MDT for local construction costs on a monthly basis.

In conjunction with requiring local governments pay their portion of construction costs on a monthly basis, MDT should bill local governments monthly for local construction costs. Local governments identified the volume of information to be verified during the billing cycle as a possible source of reimbursement delays. This was particularly true for contracts that did not bill monthly. This procedural change should reduce the time required to verify billing information by local governments and result in fewer reimbursement delays.

More Information is Needed for Miscellaneous Items

During discussions with local governments, “miscellaneous” items on MDT bills were identified as a source of possible payment delays. Both MDT and local governments recognized the need for a miscellaneous category on a billing statement. However, local governments stated more information was needed to identify what project work was accomplished as part of these billed items. This is

Chapter VI - How Can MDT Improve Their Current Process?

especially true when the local government is not able to have a local representative on the project at all times.

As part of this audit, we did not determine how often miscellaneous items in a local government's bill resulted in a delayed reimbursement to MDT. We did notice each of the progress estimates we reviewed did include a "miscellaneous" line item. Local government officials we contacted indicated miscellaneous items that cannot be positively identified to a specific activity frequently result in a request for more information before payment can be made. If local government representation were available continuously on the construction site, miscellaneous items could be more easily identified. However, local governments indicated labor levels frequently force them to have local representation on the site only when the local government is completely responsible for the activity occurring. When that work is completed, the local representative frequently travels to another project in progress. Local information we reviewed showed requests for additional information could result in delays of 30 days or more.

The lack of additional detail in billing statements does not explain why some local governments are able to meet their reimbursement obligations before their accounts are overdue and others do not. However, it is a source of potential delay that can be reduced by minor procedural changes in the billing process. If MDT were to provide additional detail in the bill submitted to the local government for payment a source of possible reimbursement delay could be eliminated.

Recommendation #3

We recommend MDT amend its contract language for joint projects with local governments to:

- A. Require monthly billing and reimbursement for local construction costs.**
- B. Address details that will be provided to local governments for all items identified as "miscellaneous" in monthly bills.**

Agency Response



Montana Department of Transportation

2701 Prospect Avenue
PO Box 201001
Helena MT 59620-1001

Jim Lynch, Director
Brian Schweitzer, Governor

December 29, 2005

RECEIVED
JAN 03 2006
LEGISLATIVE AUDIT DIV.

Scott Seacat, Legislative Auditor
Legislative Audit Division
State Capitol Room 160
Helena MT 59620-1705

Subject: Local government reimbursement for joint construction costs

Dear Scott,

Thank you for giving the Montana Department of Transportation an opportunity to response to the performance audit performed by your office for local government reimbursement for joint construction costs. Enclosed is our detailed response including an management action plan.

I appreciated your staff's hard work, cooperation, and professionalism during this audit.

This department is committed to complying with state and federal laws, implementing and maintaining effective accounting controls, and presenting an accurate and fair financial picture.

Sincerely,

Jim Lynch
Director

attachment

copies: Monte Brown, Administration Division Administrator
Dennis Sheehy, Internal Audit Unit Manager

**LEGISLATIVE AUDIT DIVISION
PERFORMANCE AUDIT**

LOCAL GOVERNMENT REIMBURSEMENT FOR JOINT CONSTRUCTION COSTS

AGENCY RESPONSE

Recommendation #1

We recommend MDT:

- A. Charge local governments interest on overdue accounts*
- B. Withhold local disbursement of state collected transportation related funds when governments fail to reimburse MDT for construction costs within an established timeframe*
- C. If necessary seek statutory authority to implement actions A & B*

Agency Response

A. Concur:

The Department will work with the administration to determine if we will seek legislation in order to charge interest.

Action Plan: The Department will work with MDT Legal Services regarding specific legislation to be submitted by the next legislative submission deadline date if approved by administration. We will also work to identify other alternatives available to the department.

B. Concur:

The Department will work with MDT Legal Services to determine what, if any, options and or legislation is necessary to allow MDT to withhold local disbursement of state collected funds for failure to reimburse construction costs by local governments.

Action Plan: The Department will work with Legal Services to determine options or if legislation is necessary to allow withholding of local disbursement of state collected funds for failure to reimburse for construction costs. If approved by administration, legislation will be submitted by the submission deadline. If legislation is not necessary, department policy and procedures will be drafted and implemented by July 1, 2006.

C. Concur:

See responses to A & B.

Recommendation #2

We recommend MDT require local governments pre-fund a portion of their anticipated local construction costs prior to contract award.

Agency Response

Concur:

The Department will look at options available regarding local governments pre-funding a portion of their anticipated local construction costs prior to contract award.

Action Plan: The Department will develop options with recommendations regarding pre-funding for local governments by June 2006. Upon administration approval an implementation plan will be developed.

Recommendation #3

We recommend MDT amend its contract language for joint projects with local governments to:

- A. Require monthly billing and reimbursement for local construction costs*
- B. Address details that will be provided to local governments for all items identified as "miscellaneous" in monthly bills.*

Agency Response

A. Concur:

The Department will formalize an MDT policy in developing contracts with local governments to require monthly billing and reimbursement. The Department will also work with administration to develop procedures to enforce contract language and collections.

Action Plan: The Department will work with Legal Services to formalize the policy by 2/28/06 for administration approval. The Department will develop a plan to implement procedures to ensure enforcement of contract language and collection by 6/30/06.

B. Concur:

The Department will work with the MDT Divisions to determine what detailed information will be included in the billings.

Action Plan: The Department will perform a business process review to determine what is necessary to align bills with contract items by 6/30/06.

Management Action Plan - LAD Audits
MDT Financial / Compliance Audit
For the two Fiscal Years Ending June 30, 2004 and 2005

Audit Recommendation #	Management View	Corrective Action Plan	Responsible Area	Target Date
Recommendation #1 We recommend MDT:	Concur		Legal Services Division, Administration Division, Construction Bureau	7/1/2006
A. Charge local governments interest on overdue accounts		The Department will work with MDT Legal Services regarding specific legislation to be submitted by the next legislative submission deadline date if approved by administration. We will also work to identify other alternatives available to the department.		
B. Withhold local disbursement of state collected transportation related funds when governments fail to reimburse MDT for construction costs within an established timeframe		The Department will work with Legal Services to determine options or if legislation is necessary to allow withholding of local disbursement of state collected funds for failure to reimburse for construction costs. If approved by administration, legislation will be submitted by the submission deadline. If legislation is not necessary, department policy and procedures will be drafted and implemented by July 1, 2006.		
C. If necessary seek statutory authority to implement actions A & B		See responses to A & B.		
Recommendation #2	Concur		Engineering Division, Transportation Planning Division	6/30/2006
We recommend MDT require local governments pre-fund a portion of their anticipated local construction costs prior to contract award.		The Department will develop options with recommendations regarding pre-funding for local governments by June 2006. Upon administration approval an implementation plan will be developed.		
Recommendation #3	Concur		Legal Services Division, Administration Division, Construction Bureau	6/30/2006
We recommend MDT amend its contract language for joint projects with local governments to:				
A. Require monthly billing and reimbursement for local construction costs		The Department will work with Legal Services to formalize the policy by 2/28/06 for administration approval. The Department will develop a plan to implement procedures to ensure enforcement of contract language and collection by 6/30/06.		
B. Address details that will be provided to local governments for all items identified as "miscellaneous" in monthly bills.		The Department will perform a business process review to determine what is necessary to align bills with contract items by 6/30/06.		